EXHIBIT B
PART 10 OF 10

EXHIBIT 2035 TO THE DECLARATION OF LISA J. CISNEROS IN SUPPORT OF PLAINTIFFS' NOTICE OF SUPPLEMENTAL MOTION AND MOTION FOR CLASS CERTIFICATION

From: Thompson, Gabrielle
To: Chaisson, Eric B; McKell, Danny; Hickam, Jodie A; Pera, Matthew M; Namie, Mike
Sent: 4/14/2005 12:49:05 PM
Subject: fyi - more on the comp debate
Attachments: FW: The compensation debate; FW: The compensation debate

EXHIBIT 2035
WIT. McKell
DATE 3-20-13
KRAMM COURT REPORTING

2035.1

From: Reid, Ogden M
To: Thompson, Gabrielle
Sent: 4/14/2005 7:00:24 AM
Subject: FW: The compensation debate

Gaby,
Here are Scott's and my comments.
Ogden

From: Fortmann, Scott
Sent: Tuesday, April 05, 2005 1:49 PM
To: Richard, Chris; Reid, Ogden M; Galvin, Tom A; Williams, Ardine; Bidal, Bill; Kettmann, Dorenda
Subject: RE: The compensation debate

Here are my thoughts. I have not had many hours to think this through, so I hope my thoughts are not glib or shallow. scott

1. I don't believe employees are confused or uneducated about our compensation. I see an alternative view. **Alternative View, *Part 1*:** Employees understand the comp system just fine; they simply don't agree with it. Despite the macroeconomic trends, they want more cash. They want more base pay. They want year-on-year pay increases that reflect their personal view of their ever-greater contributions. **Alternative View, *Part 2*:** We can't educate or market the employees out of their positions. This isn't the result of cutting Personal Portrait. This isn't a failure to market or communicate. This isn't a failure of senior managers to say the right things. This isn't the fault of Circuit News. Employees will not change their positions ***because they see this issue through the lenses of employees, not owners.*** Ten years ago, we had an "employee-owner culture" driven through fabulous SOP and SPP programs, and our employee-owners were able to appreciate the larger macroeconomic business issues. Today, we no longer have that employee-owner culture because SOP and SPP have performed miserably for almost five years. Unless our share price starts climbing dramatically, don't expect the employees' positions to change. In fact, in the worst-case scenario, our employee-owner culture will change into an "employees vs. owners culture" as employees seek more cash and the company resists giving it to them. **Implications of the Alternative View: *1.*** Putting energy into changing employees' minds is futile. They believe what they believe because they are rational. **2.** Absent valuable SOP/SPP programs to promote a long-term employee-owner view, employees will take an increasingly short-term view of the economics. They will re-evaluate the employment value proposition more far more frequently...perhaps each year when they get their pay letter. They will be more likely to ask how much money they can get at the employer next door ***today***. Now, thankfully, compensation isn't the only thing that motivates employees. We know that great work and great managers are important as well. On the other hand, we don't have a monopoly on great work or great managers, and we no longer have the best compensation package in town. *3.* What's true for employees is true for managers, too. They are thinking the same thing as employees, so we can't expect them to carry the party line about t-comp. In fact, we should expect them to support employees in this view. And we should expect them to try to spread the cash at Focal...which is what they are doing.

2. Your conclusion is that we lack pay differentiation between top and average performers because there exists only about 1 percentage point of pay differentiation between top peformers and average performers at a given grade level. While I have no doubt the data is correct, let me ask this: Is it really relevant evidence of differentiation (or lack thereof)? If you limit your analysis to a *single grade level* at a *single point in time*, I think you have to

expect to find little differentiation. Perhaps we need to take a longer-term view: ***Meaningful pay differentiation comes from the promotions an exceptional employee receives over the course of the employee's career.*** That is, if you perform very well, then you get better opportunities, and then you get promoted and paid more; the better you perform, the more this virtuous circle occurs for you and the more money you make. In comparison, if you perform adequately but not great, then you stay in grade and get small pay increases each year. Bottom line: Differentiation occurs over years and is manifested by achieving different grade levels. **Implications: *1.*** If this alternative view is correct, then there is far less pressure to differentiate pay within grade levels. At the risk of being glib, we can accept more peanut butter behavior on pay raises. 2. If promos are the vehicle for differentiation, we should focus our energies on ensuring the right employees get opportunities and promotions.

3. I agree with your conclusion that an issue exists with respect to the "enormity" of the Focal system and its ability to get people to focus not on the important deliverables, but on the process. I struggled, however, to understand the detail you articulated underneath your conclusion. I also struggled with this sentence: We increasingly see managers blindly following the process rather than exercising management judgement to do the right thing. It's been popular lately to say managers are "gaming the system" or "blindly following rules" or "abdicating judgment." I don't agree. Instead, I think we drive managers into the process weeds and rule-making game. We do this by giving them an extraordinarily complex set of decisions to manage in Focal. [redacted]

Now, is it rocket science to do all this? No. Is it a lot to deal with? Yes. Is it rational for groups of managers to try to build detailed rules and processes around this to make it easier and appear equitable? Of course. Is it logical for senior managers -- who might have to review the results of a couple dozen rank sessions -- to issue rigid edicts or rules limiting manager discretion? Absolutely. **Implications: *1.*** If we want to change managers' behaviors in Focal, we need to reduce the number of decisions we ask them to make. That means either (A) reducing the choices (e.g., fewer ratings, fewer stock levels, etc.) or (B) going with a black box approach. 2. If we don't reduce the number decisions, we can't get managers focused on the most important activities such as writing fabulous reviews.

4. Near the end of your essay, you say that we need to react to changing employee demographics and views about compensation or to competitive change in compensation philosophy and programs. I agree. This is a core issue. From a hiring perspective, I think we are starting to see indicators of the challenge of relying on stock. Our offer-to-accept remains healthy. However, as you are aware, we are starting to implement exceptions to our standard comp for hiring. These exceptions are evidence that our value proposition is beginning to fray around the edges. This is an issue that deserves more in depth study by GS and C&B.

Scott

From: Richard, Chris
Sent: Tuesday, April 05, 2005 11:48 AM
To: Reid, Ogden M; Galvin, Tom A; Williams, Ardine; Bidal, Bill; Kettmann, Dorenda; Fortmann, Scott
Subject: RE: The compensation debate

2035.3

Nice job Ogden.

Especially on the cultural paradox of egalitarianism versus meritocracy as well as the chicken and egg issue on Tcomp.

Here is what I sent to Tom earlier.

Chris

<< Message: RE: The compensation debate >>

From: Reid, Ogden M
Sent: Tuesday, April 05, 2005 11:40 AM
To: Galvin, Tom A; Williams, Ardine; Bidal, Bill; Richard, Chris; Kettmann, Dorenda; Fortmann, Scott
Subject: RE: The compensation debate

Dr. Galvin,
I agree with many of your points and won't reiterate them. To sharpen the debate, let me throw out some criticisms or additional points.

1) We put too much emphasis on inadequate communication to explain employees' lack of trust. Surely, that has played a part. A deeper reason, however, may be that coming out of the down-turn, we kept base pay levels too low, too long. Employees generally understand the T-Comp argument and that overall they are paid reasonably well to market. But since 9/11 and the recession, the world and Intel's place in it is riskier. $13 stock isn't that long ago. Employees want less risk and our variable pay system exacts a bigger risk premium than they want to tolerate. Waiting until next year's "uncertain" EB payout is less appealing than it was. In sum, lack of trust stems more from highly leveraged pay with a low base (which employees know was behind market) than poor communication or excessive complexity in design. This isn't an entirely rational thought process for employees because most have gotten their T-cash year after year and should not fear variability. To the extent they do, however, they don't trust the system.

2) Lack of trust is greater the higher up the ladder you go. Our problem is not fundamentally with lower-level exempts. It absolutely is not with non-exempts. It has its roots in our 10+ population. This population has the most leveraged pay, feels the loss of stock appreciation the most, and is most affected by nostalgia for the good old days when comp was dramatically higher. They are the ones that have the most trouble internalizing why pay levels haven't returned to their pre-bubble levels. Any solution to comp, meritocracy and performance management must target this group.

3) Many managers, even senior ones, don't really believe in full-blooded meritocracy. Much of our culture screams egalitarianism - same cubes, no parking, coach class travel, everybody gets a review with improvement areas etc. Egalitarianism is inconsistent with meritocracy. You can't be equal and better at the same time. While we pay lip service to meritocracy, we really believe more in treating everyone the same within broad bands. Yes, managers do peanut-butter to avoid giving a negative message. That is natural to human nature. Everybody gets an A at Harvard. And yes, we need to have expectations, training and tools in place to check that tendency. But until we get an honest debate about the conflict between meritocracy and egalitarianism and get true buy-in to more meritocracy, we'll get the same behavior. In my experience, Israel is pretty honest about it. They say: "Yes, there are some superstars in the top 10-15%, but after that we'd rather pay everybody the same. We are a family and as a family, we execute like the best team." We can disagree with that approach but we should put reality on the table.

4) There are many causes to the risk aversion that we see in our culture: after-effects of downturn, big company-itis, Managing for Excellence issues etc. One that isn't mentioned is that we have largely lost the ability to make people "rich" in 5-10 years. It is axiomatic that people are willing to take greater risk for higher return. The equation works both ways. When return is lower, so is risk taking. Thus, when an employee could become independently wealthy in a decade at Intel, they were more likely to take risks with "their career." If your expected career is now 20+ years, rational behavior would lead the individual to take fewer risks in year 5 of 25.
5) The way we position our market philosophy has created a chicken and egg issue that is obvious to our employees. We say that we will pay above market when we perform above market and at or below market when we perform below market. It used to be that we were no. 1 or 2 among T-Comp companies year after year. Of course, our biz performance matched that. Now, employees turn argument around and say that we perform at an average level to market because we pay at an average level to market. They say we need to pay the best to have the best performance. Instead, we don't really belief our employees will perform the best so we say prove it first, then you'll get rewarded (with later promo, EB that pays next year or stock appreciation over next 1-4 years). One way to get out of this box is to state the typical reality (without down-market hedge) in our core philosophy statement: we pay above average or among the best, and we expect you to perform at that level. It does create some entitlement and a problem when we hit a down-turn, but why manage at least in part to the down-cycle?

2035.4

6) The lack of trust, thin commitment to meritocracy, focus on the minutiae of Focal process, lack of risk taking and lack of managerial ownership are cumulatively major challenges. They don't get fixed by incrementally better communications, modest design simplification, fewer Focal rules or putting more into the Black Box. If true, how do we change the whole debate?

Ogden

From: Galvin, Tom A
Sent: Monday, April 04, 2005 12:10 PM
To: Williams, Ardine; Bidal, Bill; Richard, Chris; Kettmann, Dorenda; Fortmann, Scott; Reid, Ogden M
Subject: FW: The compensation debate

Fyi below. Please give me your thoughts.

tom

From: Murray, Patty
Sent: Monday, April 04, 2005 10:40 AM
To: Galvin, Tom A
Subject: RE: The compensation debate

Tom,
Please include Ardine, Bill, Chris Richard, Dorenda, Scott and Ogden in this discussion.
thanks

From: Galvin, Tom A
Sent: Sunday, April 03, 2005 10:57 PM
To: Murray, Patty; Taylor, Richard HR; Tunmore, Neil; Thompson, Gabrielle
Subject: The compensation debate

Here is my first pass writeup for us to begin foil creation. I have not yet been able to cast this in the Framework that Chris Richard put forth in HR staff. I will integrate that on Monday.
tom

Environment:

There are a number of Intel internal environment and external macro environment issues that describe a "problem statement" about compensation, how it is viewed, and how it is dealt with by managers at Intel. A description of these issues is a useful preface to discussing potential improvements to our complete performance management system at Intel. They are:

- Current Lack of employee trust in the compensation system
- Significant lack of employee understanding of compensation and macroecononomic impacts (specifically fixed vs profit related pay, and the current macroeconomic environment relative to jobs in mature markets)
- The reality that we have not been able to differentiate pay greatly between average and high performing employees (Jordan/Wirt 2004 study) coupled with the fact that achieving separation becomes exceedingly difficult in times of small budgets and low stock price appreciation.
- The "enormity" of the Focal system and its ability to get people to focus not on the important deliverables, but on the process. This includes a new realization that the Focal system is "like the tax code"....everyone works the process to find a loophole. Focal is also often referred to regarding inordinate amount of low value added work (splitting hairs on compensation) vs. high value add (writing good reviews, delivering expectations to employees, and motivating our high performers)
- Intel culture issues highlighted by the GES and visited routinely in HR SLRPs which begat "Managing for Excellence" ...the need to reinvigorate the manager employee relationship.

I will now touch on each of these separately to deliver background and to briefly describe the "state of the union" within Intel on each.

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Lack of trust in the compensation system: Lack of trust in the compensation system at Intel is arguably at its peak. A number of things have contributed to this over time. First was a significant removal of employee communication on T-comp with the elimination of "Personal Portrait". To save money and to not be the bearer of bad news, we made the decision early on in the downturn to end this significant employee communication and marketing tool. Second was a reduction in communication delivered about compensation methodology (how we do benchmarks, what companies make up the T-comp company benchmark set, data about what the market was delivering on Focal, etc.) This information was first de-emphasized in the 2001 cycle when "how the budget is set" discussion became subordinate to Circuit communication that we were " cutting our budget in half from what we had initially intended to deliver due to changing market conditions". This Circuit communication dawned an era where the annual Focal budget was announced on Circuit until we ended that practice this Focal 2005, returning to our prior communication method.

Employee trust has been further impacted due to the fact that despite Intel increased profitability, compensation is still well below absolute pay levels at the 2000 peak. While this is partly attributable to lack of stock price appreciation, some of the mistrust stems from lack of understanding of how pay relates to both profitability and to labor market conditions.

Lack of understanding of compensation and macroeconomic impacts: One of the biggest employee complaints about compensation these days is an apparent lack of response in the compensation system to Intel's recent increased profitability. Many employees expect that Intel's current profitability should result in compensation levels similar to the peak in 2000. This misunderstanding is firstly manifested in employee inability to separate concepts of market based pay and profit based or variable pay. It is manifested secondly in an inability to understand that Intel's total pay (including the variable pay component) is still ultimately constrained by macroeconomic conditions. The first misunderstanding has never been more prominent than in the current focal cycle. The typical refrain is "how can Intel justify paying a 2% increase to successfuls given our record performance in 2004." The second misunderstanding is more prevalent across the organization and is even present at very senior grade levels. Here employees seem to believe that because we have a profit related pay component, our variable pay and hence total pay is therfore unconstrained by market conditions. Simply stated, their reasoning is that since profitability has returned to prior levels, compensation should behave similarly. The compensation system is architected to behave similarly not on absolute compensation, but on position of market. i.e. if at a given profitability, we were 10% ahead of market, then with similar profitability, we should see our compensation return to 10% ahead of market. The problem is that the 2005 market bears no relationship to 2000 market in mature economies. Employees in mature markets are not internalizing that 10% ahead of market in 2005 could still be well below year 2000 compensation levels.

Lack of pay differentiation between top and average performers: A C&B study by Jordan and Wirt in 2003 set the stage for significant discussion by MCM in 2004 on "how much meritocracy is enough". Data in the analysis showed that (despite our best efforts on merit pay differentiation in Focal) there is only about 1 percentage point of pay differentiation between top peformers and average performers at a given grade level. This precipitated spirited debate in 2004 at MCM C&B advisory meetings about the need to "get after" meriticracy to improve separation, to maintain the distinction, and hence improve the motivation to achieve standout performance. The importance of distinguishing rewards and motivating top performance has been well chronicled in the literature. MCM recognized the need to continue pursuit of more differentiation while at the same time showing angst over the resulting impact to "solid performers in the middle". There was growing concern about retention of the successful performers when those performers are staffing critical functions. One MCM even described that it was "easier to replace 1 outstanding than 4 successfuls" (With Intel's solid reputation turnover risk of successfuls is similar to high performers).

While the new Focal tool makes it easier to detect "peanut buttering" there is still an underlying tendency by managers to "spread positive messages". We are now just better able to detect it real time. With Focal 2005 for instance, despite better adherance to O/EE/S separation ratios driven by real-time data, managers were less willing to identify outstanding and EE performers. Spreading positive messages was also evidenced early by a large incidence of "successful promo's".

The enormity of the Focal process: Despite HR's improved tool implementation, Focal emphasis by managers continues to be focused more on the process than on delivering the result (employee development, recognition, compensation, expectations). There is increasing concern that in the current econonomic environment (in the U.S. and mature markets), it is the compensation result that gets most of the attention. There is also concern that the focus on process results in the establishment of rules or support mechanisms to prescribe answers for every contingency. We increasingly see managers blindly following the process rather than exercising management judgement to do the right thing.

Intel Culture Issues: Over the course of the numerous HR SLRP discussions on Intel culture, there has been some interaction between culture issues and our performance management and rewards system. For example, Focal budget communication on Circuit was an oft quoted example of "management by Circuit" which contributed to the emphasis on improving manager/employee interaction. Risk taking is also often cited as a casualty within the current system. It goes without saying that if managers can astutely "game the system" to spread postive performance messages, employees can also game the system to elicit a positive message. The concern most often mentioned is that employees rather than "striving to perform" are "striving not to underperform". i.e. the goal is to hunker down and not get noticed.

While there is some controversy on the best way to resolve the above issues....there is very little disagreement on end state improvements we would be looking for against these objectives in any further change to our performance mangement and

reward system. In short, we want:

To restore employee faith in the compensation system.
To improve employee understanding of Intel's compensation system.
To achieve agreement on the level of importance of meritocracy to the Intel culture and how we implement it within our compensation system.
To subordinate the Focal process in favor of achieving the right results by focusing mangement attention on value added activity.
To reinvigorate a robust manager/employee relationship as an important step in recapturing our culture.

There are, however, 3 issues at the heart of the controversy in any discussion of redesign (be it tinkering with T-comp philosophy, or merely its implementation). They are:

1. How much meritocracy is enough? While we value it as a core part of the philosophy, there is growing concern about also "rewarding the middle"...ie. the issue of balancing rewards between successful and high performers while motivating and retaining both.
2. How much discretion should managers have in setting compensation within the Focal system? This comprises both the following-sub issues: "can managers bring themselves to deliver meritocracy?" and "is determining compensation a " value add" activity for managers in Focal or could the Focal result be improved by focusing managers on higher value added activities (focus on reviews, expectations, non-comp motivation, etc).
3. Have changing demographics at Intel, and in the industry, along with compensation strategy changes by competitors made it increasingly difficult for Intel to compete for talent with our current compensation design? If so, what aspects of the design have us most at risk? Egalitarianism? Adherance to Stock options as the retention vehicle? Related to this last question is the issue of whether or not our T-comp philosophy can be further simplified in implementation to improve employee understanding and/or faith in the system.

As I flesh out the controversy and areas of debate, I think it is important to consider the first two in parallel due to their interrelationship surrounding meritocracy. I will handle these first, and then deal with the other questions on philosophy and implementation last.

The Meritiocracy debate (how much and how to implement) is best understood by describing two very polar positions. Discussion in 2004 led to the conjecture that if managers continued to peanut butter rewards and not act to improve pay separation between average and high performers, that it might be better achieved by having the Focal system deliver a prgrammatic compensation result for each employee. For the purpse of ensuing discussion, we call this first position the "Black Box meritocracy" approach, and its proponents "black boxers".

Black boxers:

- Believe in Meritocracy first and foremost, especially in periods of small budgets when there is less to go around.
- Believe that pay differentiation is the key to motivating specific performance...i.e that 3x raise sends a signal. If employees don't see meaningful differentiation, they won't put in the extra effort to distinguish themselves. They also take for givent that managers' inability to differentiate rewards is evident by the past meritocracy study indication lack of differentiation, as well as the last two Focals' data results.
- Believe that Managers doing "hair splitting" with small budgets is little valued add. Taking comp out of the equation could help managers to focus on the performance management aspects of Focal (devoting time to sending clear messages, setting expectations, and writing quality reviews). i.e. this frees up time for managing for excellence
- Believe that the "more for the middle" argument is a red herring because the successful merit raise of 2% was explicitly designed to match the market. That is, while many believe in 2005 that 2% merit equates to "paying behind market", this is not the case. Employees see that 2% merit is behind inflation and then automatically assume that we must be paying behind market, and that others must be doing better elsewhere. The reality is that many U.S. jobs are not keeping up with inflation.
- Fundamentally believe in the ROI of differentiation, and the lack of ROI in spreading "peanut butter". They believe that the costs of managing "type A retention errors" (spending money where necessary on the "squeaky wheel") are smaller than the costs of managing "type b retention errors" (peanut buttering money to those with no intention of leaving).

The opposing position favors continued manager involvement in compensation while pushing managers to do better. Proponents of this manager centric approach belive that:

- Differentiation that is achievable by the merit budget is insignificant.....so pursuing it at the expense of employee morale is questionable. Spreading positive messages when there are few to go around is a good thing.

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- Thrash among populations in outstanding, EE, and S categories is significant and is evidence that distinguishing between them is difficult.
- That Promotion is the key achiveable aspect of performance and compensation differentiation.
- That black boxing compensation will increase the level of distrust among employees, and further dissavows managers from the responsibility of "owning the T-comp Philosophy"
- Removing manager responsibility for compensation will focus them even more on the compensation result of focal (the injustice of the black box) and away from their peformance management tasks and managing for excellence.
- "Black box" continues to train managers to "ask for the rules" rather than use good managegement judgement in issues of performance management and employee development. That the ultimate job of the manager is to think and black box is a step in the opposite direction.
- That "black box" is a convenient excuse for managers not to have to understand Intel's compensation philosophy but to "act as a victim" of the compensation system.
- That asking managers to own manager/employee relationships and communication but not to own compensation is fundamentally inconsistent.

Whichever position is favored for continued development of Intel's Focal strategy going forward, it is clear that two other key issues must be addressed:

1. Employee understanding of compensation (achieved either via better communication or via simplified design).
2. The potential need to react to changing employee demographics and views about compensation or to competitive change in compensation philosophy and programs.

[redacted]

With respect to changing design for employee demographics or comeptitive change, one of the key issues going forward will be the continued pressure on Egalitarian design. We have encountered this already in Mature vs. emerging market wage growth. We face it again in potential equity program redesign. A fundamental aspect of our proxy communcation was that "executives are treated like anyone else" As we determine what the possibilities are for equity participation going forward, we must try to balance this egalitarian position against market pressure to follow the pack.

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To: Thompson, Gabrielle
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Ogden

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a family, we execute like the best team." We can disagree with that approach but we should put reality on the table.

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Ogden

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tom

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- The "enormity" of the Focal system and its ability to get people to focus not on the important deliverables, but on the process. This includes a new realization that the Focal system is "like the tax code"....everyone works the process to find a loophole. Focal is also often referred to regarding inordinate amount of low value added work (splitting hairs on compensation) vs. high value add (writing good reviews, delivering expectations to employees, and motivating our high performers)
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I will now touch on each of these separately to deliver background and to briefly describe the "state of the union" within Intel on each.

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While there is some controversy on the best way to resolve the above issues....there is very little disgreement on end state improvements we would be looking for against these objectives in any further change to our performance mangement and reward system. In short, we want:

To restore employee faith in the compensation system.
To improve employee understanding of Intel's compensation system.
To achieve agreement on the level of importance of meritocracy to the Intel culture and how we implement it within our compensation system.
To subordinate the Focal process in favor of achieving the right results by focusing mangement attention on value added activity.
To reinvigorate a robust manager/employee relationship as an important step in recapturing our culture.

There are, however, 3 issues at the heart of the controversy in any discussion of redesign (be it tinkering with T-comp philosophy, or merely its implementation). They are:

1. How much meritocracy is enough? While we value it as a core part of the philosophy, there is growing concern about also "rewarding the middle"...ie. the issue of balancing rewards between successful and high performers while motivating and retaining both.
2. How much discretion should managers have in setting compensation within the Focal system? This comprises both the following-sub issues: "can managers bring themselves to deliver meritocracy?" and "is determining compensation a " value add" activity for managers in Focal or could the Focal result be improved by focusing managers on higher value added activities (focus on reviews, expectations, non-comp motivation, etc).
3. Have changing demographics at Intel, and in the industry, along with compensation strategy changes by competitors made it increasingly difficult for Intel to compete for talent with our current compensation design? If so, what aspects of the design have us most at risk? Egalitarianism? Adherance to Stock options as the retention vehicle? Related to this last question is the issue of whether or not our T-comp philosophy can be further simplified in implementation to improve employee understanding and/or faith in the system.

As I flesh out the controversy and areas of debate, I think it is important to consider the first two in parallel due to their interrelationship surrounding meritocracy. I will handle these first, and then deal with the other questions on philosophy and implementation last.

The Meritiocracy debate (how much and how to implement) is best understood by describing two very polar positions. Discussion in 2004 led to the conjecture that if managers continued to peanut butter rewards and not act to improve pay separation between average and high performers, that it might be better achieved by having the Focal system deliver a prgrammatic compensation result for each employee. For the purpse of ensuing discussion, we call this first position the "Black Box meritocracy" approach, and its proponents "black boxers".

Black boxers:

- Believe in Meritocracy first and foremost, especially in periods of small budgets when there is less to go around.
- Believe that pay differentiation is the key to motivating specific performance...i.e that 3x raise sends a signal. If employees don't see meaningful differentiation, they won't put in the extra effort to distinguish themselves. They also take for givent that managers' inability to differentiate rewards is evident by the past meritocracy study indication lack of differentiation, as well as the last two Focals' data results.

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- Believe that Managers doing "hair splitting" with small budgets is little valued add. Taking comp out of the equation could help managers to focus on the performance management aspects of Focal (devoting time to sending clear messages, setting expectations, and writing quality reviews). i.e. this frees up time for managing for excellence
- Believe that the "more for the middle" argument is a red herring because the successful merit raise of 2% was explicitly designed to match the market. That is, while many believe in 2005 that 2% merit equates to "paying behind market", this is not the case. Employees see that 2% merit is behind inflation and then automatically assume that we must be paying behind market, and that others must be doing better elsewhere. The reality is that many U.S. jobs are not keeping up with inflation.
- Fundamentally believe in the ROI of differentiation, and the lack of ROI in spreading "peanut butter". They believe that the costs of managing "type A retention errors" (spending money where necessary on the "squeaky wheel") are smaller than the costs of managing "type b retention errors" (peanut buttering money to those with no intention of leaving).

The opposing position favors continued manager involvement in compensation while pushing managers to do better. Proponents of this manager centric approach belive that:

- Differentiation that is achievable by the merit budget is insignificant.....so pursuing it at the expense of employee morale is questionable. Spreading positive messages when there are few to go around is a good thing.
- Thrash among populations in outstanding, EE, and S categories is significant and is evidence that distinguinshing between them is difficult.
- That Promotion is the key achiveable aspect of performance and compensation differentiation.
- That black boxing compensation will increase the level of distrust among employees, and further dissavows managers from the responsibility of "owning the T-comp Philosophy"
- Removing manager responsibility for compensation will focus them even more on the compensation result of focal (the injustice of the black box) and away from their peformance management tasks and managing for excellence.
- "Black box" continues to train managers to "ask for the rules" rather than use good managegement judgement in issues of performance management and employee development. That the ultimate job of the manager is to think and black box is a step in the opposite direction.
- That "black box" is a convenient excuse for managers not to have to understand Intel's compensation philosophy but to "act as a victim" of the compensation system.
- That asking managers to own manager/employee relationships and communication but not to own compensation is fundamentally inconsistent.

Whichever position is favored for continued development of Intel's Focal strategy going forward, it is clear that two other key issues must be addressed:

1. Employee understanding of compensation (achieved either via better communication or via simplified design).
2. The potential need to react to changing employee demographics and views about compensation or to competitive change in compensation philosophy and programs.

[redacted]

With respect to changing design for employee demographics or comeptitive change, one of the key issues going forward will be the continued pressure on Egalitarian design. We have encountered this already in Mature vs. emerging market wage growth. We face it again in potential equity program redesign. A fundamental aspect of our proxy communcation was that "executives are treated like anyone else" As we determine what the possibilities are for equity participation going forward, we must try to balance this egalitarian position against market pressure to follow the pack.

From:	Richard, Chris
To:	Galvin, Tom A
CC:	Richard, Chris
Sent:	4/5/2005 8:52:16 AM
Subject:	RE: The compensation debate

Tom

Here is what I would add:

I would frame this issue as asking "how do we create a system of management and compensation that gives us an engaged and performing workforce?"

Ultimately, employees want to believe that our compensation system is fair and just:

- That there is a cause and effect relationship between the results I deliver this year and the rewards I receive this year (my compensation is not up to chance). Measured by:
  1. What results did I achieve this year versus last year, and does my compensation correlate?
  2. What results did I achieve this year versus the expectations my manager set, and does my compensation correlate?
  3. What results did I achieve this year versus those I perceive others in my peer group achieved, and does my compensation correlate?
- That I believe I am being compensated fairly relative to the external market
- That the better Intel does financially, the better I do financially

I don't believe that managers want to do the wrong thing, that they are against meritocracy in principle, or that they are out to undermine the system. I believe managers try to do the right thing, and the right thing is to appropriately apply rewards based on their assessment of the employee's performance. This assessment will be made against the same three criteria that employees use to assess themselves (1-3, specified above). (They may not have the same assessment of an employee's performance as that employee does, but the bases for comparison are generally the same.)

In general, I believe that the "peanut buttering" of rewards is a reflection of managers attempting to do the right thing by applying the portfolio of rewards as they see fit, i.e. to support the employee perception of causality between effort/results and rewards. As I stated, in my own group I believe that roughly 55% of my employees exceeded expectations by measures 1-3, above. And by concentrating the rewards this year to roughly 25% of my employees, I have sent the message to the other 25% that "you may work hard, but the payoff is up to chance."

So this leads to the question: "how do best distribute my budget such that I keep my broad base of employees motivated while at the same time providing pay differentiation for my top performers?" I need to maintain a broad base of motivated employees engaged and operating with excellence today, while, at the same time, I need to invest in my top performers (who will drive the future) so that their pay is consistent with the external market.

A critical factor in this analysis is the perceived value of Intel stock and Intel stock options going forward. I think we have not been brutally honest with ourselves when it comes to assessing the soundness of our Tcomp philosophy. Let's face it, high (4-5x) EB multipliers and ever increasing stock price carried Tcomp for many, many years. People bought into the "base is lower than market, but TCASH/TCOMP is better than market in good years" because all of the years were good -- people had not experienced the downside of Tcomp for a long time. The last few years have shown a different reality. If we are truly still a growth company, and our Tcomp design will be for a growth company, then the leadership of the company needs to inspire the worforce to believe we are a growth company. The Tcomp design must be consistent with the strategy and leadership style of Intel.

So we need to figure out what role Intel stock plays in the Tcomp package then, given this, figure out how to differentiate the consistently high performers. I am no expert in this area and my thought is we need to do some serious benchmarking and research to understand compensation systems available to us (perhaps you guys have done this already, I am just not aware.) Here are a few thoughts though:

- Seems that we need to make a significant improvement to the way we define and track high performers. I know some companies have more sophisticated methods than us for this. If we can't define what a high performer is, then we can't apply appropriate rewards to that person and we end up basically rotating people through the top slots and performing "time based peanut buttering" of rewards.
- Perhaps the compensation differentiation for high performers should come at times of promotion.
- So one idea is to allow managers wide discretion as to how they apply ratings, cash and stock for their groups each year at focal. They know their people, let them do the right thing. Then, providing we can define the consistent high performers, we concentrate on their compensation at times of promotion -- taking a very hard look at past track record of performance and future expectations then applying cash and stock on a customized basis for that individual. To make it manageable, without having to create a big, complex bench planning process that spans the entire company, perhaps you create one system for Gr9 and below, which allows for more localized control, and another for Gr10+ which is more centralized... don't know, again, I'm not an expert in this area and am most interested to understand what other comp systems are in use.

In summary, I think:

- Managers want to do the right thing.
- The "peanut buttering" symptom is actually a reflection of how our workforce performs in actuality -- this is different from the mental model of the distribution we think about when we talk about "meritocracy".
- We should create a system where managers are given the authority to reward employees as they best see fit in order to motivate them.
  - If we give managers budgets that are comparable to market, then, on average, our workforce will keep up with market.
- We need to be able to better identify consistent high performers and make sure their compensation is equitable to what they command on the external market. Perhaps this is a separate process from the broad focal process, and is much more targetted and run by HR and key managerial decision makers.
- Since I don't know much about designing compensation systems, I am most interested to learn what systems exist in practice and if my thoughts have been implemented in reality (or if I am missing some big piece in my logic.)

Chris

From: Galvin, Tom A
Sent: Monday, April 04, 2005 11:10 AM
To: Williams, Ardine; Bidal, Bill; Richard, Chris; Kettmann, Dorenda; Fortmann, Scott; Reid, Ogden M
Subject: FW: The compensation debate

Fyi below. Please give me your thoughts.

tom

From: Murray, Patty
Sent: Monday, April 04, 2005 10:40 AM
To: Galvin, Tom A
Subject: RE: The compensation debate

Tom,
Please include Ardine, Bill, Chris Richard, Dorenda, Scott and Ogden in this discussion.

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thanks

From: Galvin, Tom A
Sent: Sunday, April 03, 2005 10:57 PM
To: Murray, Patty; Taylor, Richard HR; Tunmore, Neil; Thompson, Gabrielle
Subject: The compensation debate

Here is my first pass writeup for us to begin foil creation. I have not yet been able to cast this in the Framework that Chris Richard put forth in HR staff. I will integrate that on Monday.
tom

Environment:

There are a number of Intel internal environment and external macro environment issues that describe a "problem statement" about compensation, how it is viewed, and how it is dealt with by managers at Intel. A description of these issues is a useful preface to discussing potential improvements to our complete performance management system at Intel. They are:

- Current Lack of employee trust in the compensation system
- Significant lack of employee understanding of compensation and macroecononomic impacts (specifically fixed vs profit related pay, and the current macroeconomic environment relative to jobs in mature markets)
- The reality that we have not been able to differentiate pay greatly between average and high performing employees (Jordan/Wirt 2004 study) coupled with the fact that achieving separation becomes exceedingly difficult in times of small budgets and low stock price appreciation.
- The "enormity" of the Focal system and its ability to get people to focus not on the important deliverables, but on the process. This includes a new realization that the Focal system is "like the tax code"....everyone works the process to find a loophole. Focal is also often referred to regarding inordinate amount of low value added work (splitting hairs on compensation) vs. high value add (writing good reviews, delivering expectations to employees, and motivating our high performers)
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[redacted]

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[redacted]

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